

Message Text

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ACTION EA-10

INFO OCT-01 EUR-12 ISO-00 IO-10 AGR-05 CEA-01 CIAE-00

COME-00 DODE-00 EB-07 FRB-03 H-02 INR-07 INT-05 L-02

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R 020936Z MAY 75

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC 9902

INFO AMEMBASSY BONN

AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY CANBERRA

AMEMBASSY WELLINGTON

AMEMBASSY SEOUL

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LIMITED OFFICIAL USE SECTION 1 OF 2 TOKYO 5920

E.O. 1652 N/A

TAGS: EFIN, JA

SUBJECT: ECONOMIC POLICIES AND FUTURE PROSPECTS

PASS TREASURY, CEA AND FEDERAL RESERVE

1. SUMMARY: THERE IS A GROWING BELIEF BY EPA OFFICIALS
THAT CYCLICAL TROUGH WAS PROBABLY REACHED IN THE FIRST
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QUARTER OF 1975. FUTURE RECOVERY WILL HAVE TO RELY
PRIMARIALLY ON INCREASED CONSUMER PURCHASES ALTHOUGH STEPPED
UP GOVERNMENT SPENDING IS CURRENTLY PROVIDING SOME STIMULUS.
THE PROSPECT IS FOR A WEAK REVIVAL IN DOMESTIC DEMAND AND

OUTPUT, NEVERTHELESS, FUKUDA STRENUOUSLY RESISTS ANY MAJOR SHIFT IN THE PRESENT POLICY OF DEMAND "RESTRAINT". EPA BELIEVES ANY STRONG RESURGENCE IN DEMAND COULD VITIATE GOJ'S PRIMARY ECONOMIC OBJECTIVE OF ACHIEVING "ONE DIGIT" INFLATION BY MARCH 1976. FOLLOWING IS A REPORT BASED ON CONVERSATIONS WITH EP AN BOJ OFFICIALS REGARDING CURRENT ECONOMIC PROSPECTS AND DEPUTY PM FUKUDA'S POLICIES AND OBJECTIVES. IN MANY WAYS, BOJ GOV MORINAGA SUPPORTS FUKUDA'S VIEWS. END SUMMARY.

2. FIRST QUARTER PRODUCTION AND OTHER STATISTICS BEING INTERPRETED BY EPA AND BOJ OFFICIALS AS SIGN THAT CYCLICAL TROUGH MAY HAVE BEEN DECLINED FORTHREE CONSECUTIVE MONTHS (SA BASIS). PRODUCERS' SHIPMENTS HAVE RISEN FOR THE PAST TWO MONTHS WHICH IS INTERPRETED AS INDICATION INVENTORY LEVELS IN DISTRIBUTION SYSTEM NEED TO BE REPLENISHED. EVEN CUTBACKS IN PRODUCTION RATES MAY WELL HAVE RUN THEIR COURSE IF PROVISIONAL MARCH FIGURE OF SMALL RISE OVER FEB (0.6 PERCENT SA) CORRECTLY MEASURES ACTUAL SITUATION.

3. OFFICIALS HAVE NO ILLUSIONS REGARDING WEAKNESS OF CURRENT DEMAND, WHICH IS EXPECTED TO REMAIN SLACK UNTIL LATE SUMMER OR EARLY FALL. CONSUMER ATTITUDES IN RECENT MONTHS APPEAR SOMEWHAT LESS PESSIMISTIC AS INFLATION HAS SUBSIDED. PURCHASES OF AUTOS, ELECTRICAL APPLIANCES AND CLOTHING ARE REVIVING BUT DEPARTMENT STORE SALES SUGGEST NO SUBSTANTIAL PICK-UP IN TOTAL CONSUMPTION. REAL WAGES HAVE BEEN INCREASING IN PASTFOUR MONTHS BUT EPA OFFICIALS SEE NO SIGN THAT HIGH SAVINGS RATES HAVE BEGUN TO DECLINE. REAL BUSINESS FIXED INVESTMENT WILL BE LOWER IN JFY 1975 (SEE TOKYO A172) ACCORDING TO ALL SURVEYS OF INVESTMENT INTENTION. THIS IS CONSIDERED REALISTIC IN VIEW OF LOW RATE OF CAPACITY UTILIZATION (CURRENTLY AT 76.7 PERCENT OF THE 1970 LEVEL) WHICH IS LIKELY TO PERSIST UNDER PRESENT POLICIES. GOVERNMENT SPENDING AND LOANS ARE ALREADY PROVIDING SOME STIMULUS TO THE CONSTRUCTION INDUSTRY
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(SEE TOKYO 4121) BUT THERE IS LITTLE, IF ANY, ADDITIONAL STIMULUS PLANNED FOR THE REST OF THE FISCAL YEAR. SOMEWHAT GREATER EASE IN MONETARY POLICY (TOKYO 3952: 5012) IS NOT EXPECTED TO PROVIDE ANY IMMEDIATE OR SIGNIFICANT POSITIVE STIMULUS TO FINAL DOMESTIC DEMAND.

4. OFFICIALS SEEM CONFIDENT THAT PRESENT POLICIES ARE UNLIKELY TO RESULT IN ANY FURTHER CUMULATIVE DOWNWARD MOVEMENT IN THE ECONOMY. ON THE OTHER HAND, CONTINUATION OF "RESTRAINT" IS CONSIDERED ESSENTIAL BY FUKUDA FOR ACHIEVING GOJ OBJECTIVE OF ONE-DIGIT INFLATION BY MARCH 1976 (DEFINED AS NO MORE THAN A 9.9 PERCENT RISE IN THE

NATIONAL CPI, MARCH 1976 OVER MARCH 1975). THAT VIEW IS SHARED BY BOJ GOV MORINAGA WHO SAID IN RECENT PRESS INTERVIEW "FIGURATIVELY UP UNTIL RECENTLY, DUE TO THE ABNORMAL

SITUATION, AND IT IS ONLY NOW THAT IT AS ABLE TO LEAVE THE HOSPITAL. IT IS ALSO STILL AT THE STAGE OF CONVALESCING AT HOME. OVERDRINKING AND OVEREATING ARE TABOO. THE CALMING DOWN OF COMMODITY PRICES IS STILL NOT GENUINE ANF THERE ARE INDUSTRIAL CIRCLES WHICH WOULD LIKE TO INCLUDE COST INCREASES IN THEIR PRICES. THEREFORE, WINDOW GUIDANCE WILL ALSO BE CONTINUED FOR ONE MORE YEAR, AT LEAST, AND THE RATHER RESTRICTIVE POLICY WILL BE CONTINUED FOR A LONGER PERIOD THAN THAT".

5. EPA DIR MIYAZAKI CONCEDED TO FINATT THAT (1) GOJ ORIGINAL INFLATION TARGET OF 15 PERCENT BY MARCH 1975 HAS ALREADY BEEN MET, (2) WAGE SETTLEMENTS THIS SPRING WILL AVERAGE SUBSTANTIALLY LESS THAN HAD BEEN PREVIOUSLY FEARED, AND (3) THE ECONOMY IS OPERATING WITH SUBSTANTIALLY MORE SLACK AND LARGER STOCK OF UNSOLD GOODS THAN HAD BEEN PREVIOUSLY ANTICIPATED. NEVERTHELESS, HE INSISTED THAT INFLATIONARY FORCES REMAINED STRONG AND COULD ONLY BE HELD IN CHECK THROUGH CONTINUED HIGH LEVELS OF UNDERUTILIZATION. THEREFORE ONLY MODEST ECONOMIC EXPANSION WAS NECESSARY. OFFICIALS DO NOT ACCEPT ARGUMENT THAT A FASTER RECOVERY RATE (WHICH USUALLY RESULTS IN RAPID PRODUCTIVITY SPURT DURING AN INITIAL RECOVERY PHASE) WOULD BE EQUALLY EFFECTIVE IN DEALING WITH INFLATIONARY THREAT.

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6. GOH REASONING REGARDING RESTRAINT IS AS FOLLOWS: IT IS TRUE THAT UNIT LABOR COSTS HAVE RISEN RAPIDLY; BUT EVEN A MODEST BUSINESS EXPANSION WILL CREATE SUFFICIENT PRODUCTIVITY ADVANCE TO ABSORB THIS YEAR'S WAGE INCREASE. LABOR REPRESENTS BETWEEN ONE-QUARTER TO ONE-THIRD OF TOTAL COSTS SO THAT AS LITTLE AS 5 PERCENT PRODUCTIVITY ADVANCE WOULD COVER UP TO 15 PERCENT INCREASE IN WAGE COST. PRICES OF NON-LABOR INPUTS (E.G. RAW AND OTHER MATERIALS) ARE LIKELY TO CONTINUE THE DECLINES OF RECENT MONTHS. THUS, EVEN WITHOUT SHARP INCREASE IN CAPACITY UTILIZATION TOTAL UNIT COSTS SHOULD REMAIN STEADY. ON OTHER HAND, STRONG BUSINESS DESIRE TO RAISE PRICES CAN ONLY BE EFFECTIVELY DEALT WITH IF UNUTILIZED CAPACITY REMAINS LARGE, ACCORDING TO FUKUDA.

7. A SECOND REASON FOR RESTRAINING THE SPEED OF RECOVERY IS TO ACHIEVE A "SOFT LANDING" ON A MUCH SLOWER MEDIUM-TERM ECONOMIC GROWTH RATE. IF RECOVERY WERE TOO FAST, IT COULD SPARK ANOTHER TRADITIONAL JAPANESE INVESTMENT BOOM WHICH WOULD CARRY THE ECONOMY WELL ABOVE

A SUSTAINABLE MEDIUM-TERM GROWTH RATE. FOR OVER 15 YEARS
FUKUDA HAS ADVOCATED A STEADIER AND SLOWER RATE OF
ECONOMIC ADVANCE FOR JAPAN. AT PRESENT HE BELIEVES
4 TO 5 PERCENT ANNUAL RATE IS SUSTAINABLE OVER THE
MEDIUM TERM IN VIEW OF SUPPLY LIMITATIONS IN JAPAN AND
RAW MATERIAL AVAILABILITY IN THE WORLD. EPA IS CURRENTLY

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R 020936Z MAY 75

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INITIATING A NEW STUDY ON JAPAN'S MEDIUM-TERM GROWTH
PROSPECTS BUT REPORT WILL PROBABLY NOT BE COMPLETED UNTIL
1976.

8. OFFICIALS CONCEDE THAT GAP BETWEEN ACTUAL AND
POTENTIAL OUTPUT WILL NOT NARROW UNDER PRESENT POLICIES.
OFFICIALS ALSO REALIZE THAT GAP LIKELY TO HAVE SOME
IMPLICATIONS ON SIZE OF EXTERNAL BALANCE AND, THEREFORE,
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ON OTHER COUNTRIES. FUKUDA IS REPORTEDLY WELL AWARE OF COMPLAINTS BY NEIGHBORING COUNTRIES OF THE ADVERSE IMPACT ON THEIR ECONOMIES OF JAPAN'S SEVERE ECONOMIC SLUMP. HE KNOWS THAT FOR KOREA EXPORTS TO JAPAN WERE OFF 42 PERCENT (FOURTH QUARTER 1974 OVER FOURTH QUARTER 1973), WHEREAS KOREA'S GLOBAL EXPORTS WERE OFF ONLY 5.5 PERCENT; FOR TAIWAN COMPARABLE PERCENTAGES ARE 44 AND 9.9 FOR HONG KONG 35 AND 18.9; FOR AUSTRALIA, EXPORTS TO JAPAN ARE DOWN 2.3 PERCENT WHEREAS GLOBAL EXPORTS ARE UP 4.1 PERCENT. PHILIPPINE EXPORTS TO JAPAN ARE UP 15.4 PERCENT WHEREAS GLOBAL EXPORTS ARE UP 28.9 PERCENT.

9. JAPAN'S IMPORTS IN FIRST QUARTER 1975 WERE DOWN 16.7 PERCENT IN REAL TERMS FROM SAME QUARTER LAST YEAR AND UP ONLY 2.2 PERCENT IN DOLLAR VALUE. ACCORDING TO BOJ OFFICIAL, RECENT IMPORTS ARE NOT MODEL OF JAPAN'S TRADE. HOWEVER, FOR CERTAIN PRODUCTS (E.G. TEXTILES AND MEAT) THERE IS SERIOUS DOMESTIC OVERSUPPLY AND INCREASED COMPLETION BY NEIGHBORING COUNTRIES. EMBASSY NOTES THAT, SO FAR, THERE HAVE BEEN FEW RESTRICTIONS PLACED ON IMPORTS INTO JAPAN.

10. JAPAN'S CURRENT EXPORTS ARE UP 11.1 PERCENT IN REAL TERMS FIRST QUARTER 1975 OVER YEAR EARLIER BUT UP 31.5 PERCENT IN DOLLAR VALUE. CONFORMANCE TO ECONOMETRIC MODEL RESULTS ARE NOT ESPECIALLY CLOSE PARTLY BECAUSE MODEL COULDN'T PROJECT LARGE EXPORT INCREASES TO MIDDLE EAST COUNTRIES (UP 107.7 PERCENT IN 1974) AND TO COMMUNIST COUNTRIES (UP 101.2 PERCENT). PICK-UP IN JAPAN'S EXPORTS TO ALL OTHER REGIONS IS NOT ANTICIPATED UNTIL LATE THIS YEAR IN VIEW OF CURRENT GLOOMY WORLD TRADE PROSPECTS (OECD)

11. OFFICIALS WERE QUITE OPEN IN DISCUSSING CURRENT POLICY AND OFFICIAL THINKING WITH FINATT. DIRECTION OF POLICY IS CLEAR BUT ITS IMPACT IS DIFFICULT TO ASSESS. SOME OFFICIALS HOPE MONETARY POLICY CAN BE RELIED UPON FOR SOME FINE TUNING BUT OTHERS NOT QUITE SO SURE. ON FISCAL SIDE, SOME OFFICIALS ON MOF AND BOJ ARE CONCERNED THAT SHORTFALLS IN TAX REVENUE AND CONSEQUENT INCREASE IN GENERAL ACCOUNT BUDGET DEFICIT ARE A POTENTIAL NEW

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SOURCE OF INFLATION. OTHERS, HOWEVER, SEE DEFICIT AS A NATURAL CONSEQUENCE OF BUILT-IN FISCAL STABILIZERS AND THINK IT CAN EASILY BE FINANCED IN NON-INFLATIONARY MANNER THROUGH NORMAL RECEIPTS OF POSTAL SAVINGS AND

SOME ADMINISTRATIVE JUGGLING OF BUDGET ACCOUNTING PRACTICES. ANOTHER SOURCE OF CONCERN IS LACK OF JOB OPPORTUNITIES AND LIKELY INCREASING INEQUALITY IN INCOME AND WEALTH AS RESULT OF DEEP AND PROLONGED RECESSION.

12. GOJ POLICY CHOICE HAS BEEN CRITICIZED BY THE JAPAN ECONOMIC RESEARCH CENTER (JERC IS AN INDEPENDENT RESEARCH INSTITUTE WHOSE CHAIRMAN, THE WELL-KNOWN DR. SABURO OKITA, IS PRESIDENT OF GOJ'S OVERSEAS ECONOMIC COOPERATION FUND AND IS REPORTED TO BE A CLOSE FRIEND OF PM MIKI). THE MARCH JERC FORECAST OF THE JAPANESE ECONOMY, WHICH APPEARS TO TAKE INTO ACCOUNT MOST OF THE RECENT AND PROSPECTIVE GOJ POLICIES, CONTAINED THE FOLLOWING COMMENTS (WHICH PROBABLY REPRESENT VIEWS OF JERC PRESIDENT HISAO KANAMORI): CURRENT DEMAND MANAGEMENT POLICY GEARED TO LOW GROWTH SEEMS TO BE MISTAKEN IN THAT EXCESSIVE PREOCCUPATION WITH RESTRAINT ON WAGE INCREASE IS RESULTING IN A SENSELESS PROLONGATION OF RECESSION AND HEIGHTENING OF UNEASINESS ABOUT UNEMPLOYMENT. IT, MOREOVER, SEEMS TO LACK CONSIDERATIONS TO THE BROADENING SURPLUS IN THE BALANCE OF PAYMENTS. THE LOW GROWTH COURSE HAS ITS VALUE, IF COURSE, SUCH AS AN UNEXPECTEDLY FAST DROP IN PRICE INCREASES AND EMERGENCE OF SEEMINGLY STEADY AND RATIONAL ATTITUDES TOWARD CONSUMPTION. THE CHANGE IN CONSUMPTION IS BEING REALIZED TO SOME EXTENT AT THE EXPENSE OF LOW INCOME GROUPS. THE MERIT OF THE LOW GROWTH COURSE MUST BE BALANCED AGAINST THESE FACTS."

13. NO OFFICIALS WAS WILLING TO VENTURE QUANTITATIVE ESTIMATE OF GNP AND B/P FORECASTS. WE INTERPRET RETICENCE AS CONFIRMATION KEY OFFICIALS NO LONGER SUBSCRIBE TO OFFICIALS GOJ ESTIMATE OF 4.3 PERCENT INCREASE IN REAL GNP JFY 1975.

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14. PRIVATE FORECASTS ARE ALL OVER THE LOT AND BEING REVISED FREQUENTLY AND BY LARGE AMOUNTS AND PERCENTAGES. JERC, FOR EXAMPLE, WHICH AS RECENTLY AS NOVEMBER 1974 WAS PREDICTING 8 PERCENT INCREASE IN REAL GNP JFY 1975 LOWEERED ITS ESTIMATE IN MARCH TO 2.6 PERCENT (1.4 PERCENT CY 1975). KEIDANREN (FEDERATION OF ECONOMIC ORGANIZATIONS) IN MARCH PREDICTED 3.4 PERCENT REAL GROWTH FOR SAME PERIOD. FOR TRADE SURPLUS JERC FORECASTS \$11.5 BIL JFY 1975 (\$10.2 BIL CY 1975) WHEREAS KEIDANREN FORECASTS ONLY \$4.2 BIL; AND ON CURRENT ACCOUNT JERC PREDICTS SURPLUS OF \$5.6 BIL (CY 1975 \$4.4 BIL) WHEREAS KEIDANREN ANTICIPATES ONLY \$50 MIL IN JFY 1975. WITH

RESPECT TO INDEX OF INDUSTRIAL PRODUCTION (MINING AND
MANUFACTURING) IN JFY 1975 JERC PREDICTS 6.7 PERCENT
DECLINE WHILE KEIDANREN PREDICTS INCREASE OF 3.8 PERCENT.
ACCORDING TO JERC, INDEX IN FINAL FORECAST QUARTER (THIRD
QUARTER 1976) WOULDSTILL BE SOME 5.5 PERCENT BELOW
PREVIOUS PEAK REACHED ALMOST 3 YEARS EARLIER, NAMELY
IN THE FOURTH QUARTER OF 1973.
HODGSON

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